2. Valuation Methods under Market Approach

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How to do Valuation?

Valuation Hierarchy as per IndAS 113

- Approaches to Valuation
  - Income Approach
    - Income Capitalization Method
    - Discounted Cash Flow method
  - Market Approach — Quoted Price (Level 1 Input)
    - Comparable Company method
    - Comparable Transaction Method
  - Asset / Cost Approach
    - Book Value Method
    - Adjusted Book Value Method
    - Replacement Method (As is What is)
    - Liquidation Value Method

Level 3 Input

Most fundamental, dependable and reliable. Ignore at your own Risk

Level 2 Input

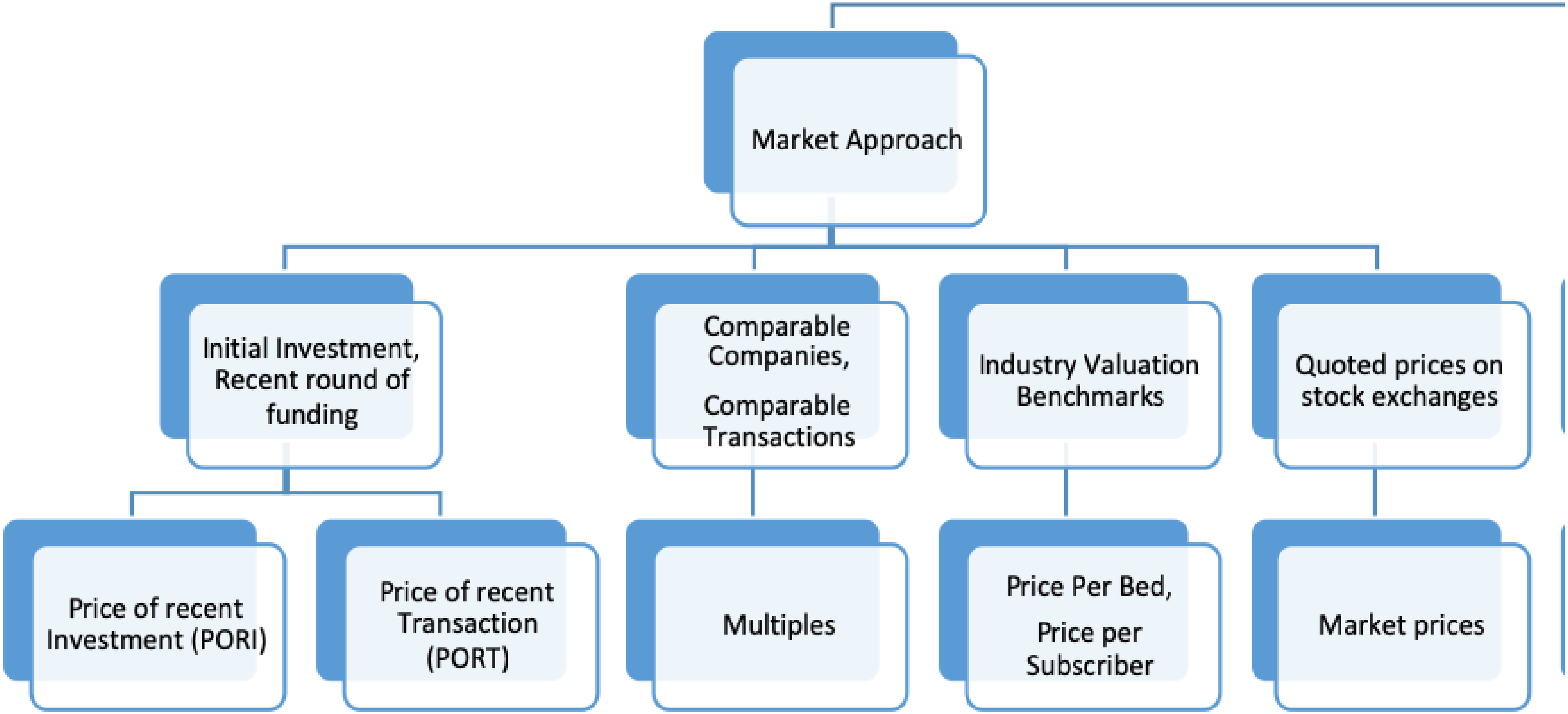
Quoted Price Ok but should be crosschecked with DCFM. View Quoted Prices with professional skepticism

Good mostly in cases of Liquidation. Indicates the downside Value.

All these approaches & methods only give us reference point and not the price.

As Valuation Professionals, arriving at the "Fair Value" by using whichever approach or method, got to be our main driver.

Valuation Methods under Market Approach



1. Market or Quoted Price Method (MPM or QPM)

- Commonly used for listed and frequently traded companies
- **Most objective way to determine a company's market or equity value**
- Equity Value as per MPM/QPM = Equity Share Price of Company * no. of outstanding shares.
- Applicability of Control Premium may need to be assessed.

2. Comparable Companies' Multiples (CCM) Method

a) Comparable Companies' Quoted Multiples (CCQM) Method

a) What is quoted multiple?
b) Price to Earning Ratio (P/E Ratio)
c) Company XYZ Ltd as unlisted company is interested to know its Value. ABC Ltd. is a comparable company listed on BSE. The Current Market Price of ABC Ltd on BSE is 400/- and its EPS is Rs. 40.
d) What will be the Price of the equity share of XYZ whose EPS is Rs. 35/-.

b) Comparable Companies' Transaction Multiples (CCTM) Method

a) What is transaction multiple?
b) XYZ Ltd is a five star hotel with 200 rooms in Cannaught Place in New Delhi. Recently its was sold for Rs. 100 crores.
c) MNP Ltd also has a five star property situated in Cannaught place with 300 rooms with similar facilities and features.
d) What should be the valuation of MNP?.

Steps in valuing a company using CCM Method

- Identification of comparable companies
- Selection and computation of multiples
- Comparison of valuation subject with comparable companies
- Adjustment to multiples
- Application of multiples on appropriate parameter
- Derivation of value

Common financial multiples used and rationale behind the same

Multiple	Rationale
Price to Earning (P/E) Multiple	• Is used very frequently by all the analysts, valuers etc. • This metric is ideal for helping investors understand exactly what the market is willing to pay for the company's earnings, when you reverse the multiple to E/P.
Cashflow multiple	• Firm Value / Cashflow of the Firm,
Sales Multiples	• Used for **early stage companies** which are loss making at the EBITDA or PAT level. • Applicable even when earnings are highly cyclical
EBITDA Multiple	• EV arrived based on the EV/EBITDA multiple is subsequently adjusted with net debt to arrive at the equity value.
EBIT Multiple	• Used as a proxy for the EBITDA multiple, when there are different models followed by the valuation subject and within comparable companies with respect to asset financing (i.e. mix of leases, rentals and ownership)
Asset Multiple	• Extensively used in valuing Financial companies

Non-financial multiples / Benchmarks used and rationale behind the same

Multiple	Rationale
EV / Capacity	For a cement company or a refinery
EV / Tower	For a passive infrastructure company
EV / Bed	For a Hospital, Health care facilities and also a Hotel
EV / MW	Power companies
EV / Reserves	Mining companies
Customer multiple	Firm value / customers. For companies like, Facebook, WA, LinkedIn, Credit Card Company etc

These metrics are best used in addition to financial metrics for benchmarking.

Why use EBIT as a multiple and not EBITDA in certain cases?

- **Subject Company (SC)** is in retail and uses malls all over which are all self-financed. Whereas, the **Comparable Company (CC)** is also in retail trade but **uses leased facility** instead of owning its own malls.
- Here, if you will use EBITDA of the CC as the multiple, for valuing the SC, you will conclude higher valuation for the subject company.

3 & 4. Comparison of valuation subject with comparable companies and adjustment of multiples

- Comparison to be done between the subject company and the CCs on various parameters such as:
  - Size, sales/profit growth, profit margins and return on equity/capital employed and on certain industry specific factors.
  - The above stated multiples to be adjusted for the differences between the Subject and CCs.
  - SWOT of the Subject and the CCs helps in estimating required adjustments.
- You can **arrive at an average of the multiple of varios CCs or a weighted average applying higher weights to companies** which are more comparable and low weights to those which are less comparable.

Examples of adjustments to comparables data

1. Inventory Accounting (LIFO / FIFO)
2. Extra Ordinary items e.g. litigation settlement
3. Non-recurring items e.g. Discounted operations, asset sales
4. Owner’s compensation
5. Capitalisation of Intangibles (from prior acquisition)
6. Non-operating assets e.g., excess cash and idle land

5. Application of multiples on appropriate parameter

- The following evaluations to be done:
    1. Do the current earnings reflect company’s actual earning capacity
    2. Any one time event which has affected the current earnings
    3. Do the earnings include any non-operating income or expense.
- If current profits are not maintainable one, then adjust the current earning or use forward earnings or a combination of both.
- Ensure that the multiples of the CCs also, are based on maintainable earnings.

6. Derivation of value

- Upon applying the adjusted multiple of the CCs to the appropriate parameter of the valuation subject, you will arrive at the EV or the equity value as the case may be.
- Adjust the above for liquidity/marketability discount or control premium

Limitations of Market Approach and various Methods of Valuation thereunder.

How reliable are the Market quotes for business valuations?

How do you explain fall in valuation of these companies?

1. Reliance Infra - 2500 > 42.70
2. Rel Capital - 2924 > 62
3. Rel Power - 430 > 4.15
4. R COM - 800 > 1.45
5. R NAVAL - 117 > 3
6. DHFL - 690 > 62.90
7. Jet Airways - 883 > 33
8. Jain Irrigation - 264 > 25
9. PC jewellers - 600 > 45
10. Vakrangee - 515 > 31
11. Suzlon - 400 > 3.35
12. Kwality - 225> 2.45
13. JP Associates - 339 > 2.70
14. JP Power - 140 > 1.90
15. JP Infra - 100 > 1.60
16. manpasand beverages - 500 > 28
17. Central Bank - 210 > 22
18. J&K Bank - 176 > 34.70
19. Mercator - 165 > 1.65
20. Aban offshore - 5400 > 35.40
21. Sintex Plastic Tech - 120 > 8
22. BPL 152 > 21
23. HDIL 1100 > 14.50
24. Videocon 760 > 1.70
25. MTNL 217 > 7.60
26. ILFS 308 > 3.10
27. Cox & King - 367 > 62.70
28. Mcleod Russel - 325 > 18.85
29. Eros Int - 643 > 25.80
30. LEEL Electricals - 340 > 7.30

Therefore, always remember, Cash is the King

31. Alok Ind 105 > 3.80
32. Subex 725 > 5.80
33. Adlabs - 207 > 4.05
34. Atlanta - 270 > 9.30
35. IFCI - 114 > 7.65
36. GMR Infra - 124 > 14.80
37. Uttam Galva - 172 > 7.55
38. Oil Country - 172 > 5.90
39. Punj Llyod - 580 > 1.25
40. Lovable lingerie - 612 > 69
41. Shree Renuka Sugar - 120 > 9
42. Patel Eng - 1020 > 18.80
43. RS Software - 400 > 20.75
44. On mobile - 361 > 31.15
45. Windsor machines - 150 > 25.10
46. Bartronics - 255 > 3.90
47. Rolta - 375 > 5.45
48. kohinoor food - 136 > 16.30
49. Dolphin offshore - 445 > 29.40
50. Snowman logist - 130 > 29.50
51. IRB INFRA 310 > 93
52. HEG 4500 > 1320
53. Varroc Engineers 1151 > 450
54. Goa Carbon 1185 > 340
55. Hotel leela 85 > 7.55
56. Vodafone Idea 118 > 11.35
57. Educomp 1100 > 1.50
58. VIP Clothing 100 > 11.70
59. Gati 290 > 57
60. GTPL 180 > 58

What must have been the reason for such a debacle in case of all of these companies?
And what lessons does it hold for we Valuation Professionals?

Potential for misuse of Comparables

- Mr. X is valuing an IPO of a firm that manufactures computer software.
- P/E multiples of some of the other companies developing software are as follows

S.No	Company	P/E Multiple
1	Adobe systems	23.2
2	Autodesk	20.4
3	Borderbund	32.8
4	Computer Associates	18.0
5	Oracle	37.8
6	Novell	30.0
7	Software Publishing	10.6
	Average P/E Ratio of 7 firms	**24.69**
	Average P/E Without Borderbund & Oracle	**22.0**
	Average P/E Without Computer Associates & Software publishing	**28.84**

What do you make out from this table?

Summary of Market Approach for Business Valuations.

- Also refer the PPT on IndAS 113 ON FV Measurement given in the folder relating to IndASs in this Master folder itself.

“Thank You”

Opportunities always come with Responsibilities.

Let Us, Make The Difference

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